market as a result of imperfections in market forces -- lumpiness of capital, rigidities in factor responses (i.e. land and labor), etc. It would be a grave error for the FCC to build its pricing model on the fundamental premise of market imperfections.

To the extent that the Commission feels a transition period is necessary to handle the change in industry structure, it should apply very specific principles to these costs.

- Cost proceedings must be conducted to exclude excess profits, inefficiencies, etc.
- As long as these costs are being shielded from market forces, opportunities for increased revenues should not be opened. This preserves the risk/reward balance in the law and recognizes that the players in all markets have joint, common and historic costs that they would like to recover
- As long as LEC joint and common costs are protected from competition, incumbents in other markets should receive similar consideration.

Interconnection Charges: The LECs advocate reciprocal compensation at their bloated, embedded costs while the IXCs propose a system of "bill and keep." In our initial comments we advocated an approach to interconnection that lies between the proposals of the LECs and IXCs. Mutual traffic exchange is a form of compensation that relies on the underlying values of services exchanged and prevents the inefficiencies of the incumbents from being rewarded. Mutual traffic exchange represents reciprocal compensation in kind. Each company receives exactly what it provides -- the termination of calls This form of exchange saves on a host of transaction costs which are likely to burden the network To suggest that a form of exchange which has been prevalent in the industry for the better part of century is an unconstitutional taking is without merit.

To the extent that a short term imbalance problem can be demonstrated, a simple

compensation mechanism to settle up imbalances could be developed.

V. THE LEC ROAD TO NEGOTIATED COMPETITION LEADS TO A DEAD END

As previously noted, several of the LECs are already showing bad faith by advocating a torturous process through which entrants would have to go to obtain interconnection and unbundling of network elements. They are a veritable mine field through which no entrant is likely to be able to negotiate safely. The companies which propose the most extreme conditions on entry are the two companies for which no competitor has been certified and in whose service territory current rules for local competition are the least well-developed.

A. RESTRUCTURE RATES

The companies which would impose the most drawn out and difficult process for opening up the local market to competition are also the companies which insist that before the process begins, they be given the most immediate and extensive restructuring of rates.[23]

The list of rate changes includes:

- geographic deaveraging
- rate rebalancing

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[23] "The Commission's stated long-term goal for interconnection pricing, including reciprocal compensation, is obtaining equivalent prices for functionally equivalent services, unless there are cost differences or policy considerations that justify different rates... However, to reach its stated goals, the Commission must institute and complete several vital, interrelated proceedings. The 'Regulatory Task List," the elements of which are indispensable to the introduction of full and fair competition to telecommunications services marketplace, includes all of the Commission and state regulatory rulemakings or other initiatives which reduce the amount of implicit service support and carrier-of-last resort obligations in LEC access and toll charges. The Regulatory Task List includes, but is not limited to, proceedings to accomplish access charge structure reform and local exchange carrier rate rebalancing and geographic rate deaveraging to the extent permitted by law." (SBC, p. 59)

- recovery of under-depreciated plant
- restructure of local switching rates
- restructure transport and interconnection charges
- eliminate enhanced service provider exemption

USTA goes out of its way to draw attention to rate restructuring as "a threshold matter" prerequisite to other policies. It goes on to single out a number of federal policies:

> Regulatory constructs, such as the carrier common line charge ("CCLC") and the residual interconnection charge ("RIC") should be restructured, and any subsidies should be narrowly targeted and explicit in terms of the universal service goals that they are designed to foster.[24]

The LEC comments expose an attempt to take advantage of the regulatory changes brought about by passage of the 1996 Act. This follows the pattern established by these same companies at divestiture when they advocated for massive local rate increases in the form of the subscriber line charge to protect them from economic uncertainty. The local rate increases from 1984 proved unnecessary and led to the record earnings by the LECs. We believe everyone should learn from history and this policy should not be repeated here.

B. ACKNOWLEDGE THE EXISTENCE OF AN OFFER

LECs have proposed that offers should be subject to restrictions before they are treated as bona fide. Thus the process is transformed from the entrant having the initiative by making an offer, to the incumbent gaining leverage by being able to claim that an offer is not bone fide. This argument appears to permit the incumbents to slow the process down before it even begins.

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[24]USTA, p. 4.

The LEC proposal would further impose conditions on the entrants, requiring them to order the unbundled elements or pay the LEC costs of processing their request, commit to pay for all costs incurred up until any point of cancellation, and to make identical unbundling arrangements available to the incumbents.

These conditions recreate exactly the problem that sections 251 and 252 were intended to correct, significant barriers to entry. The incumbent has had decades to deploy a ubiquitous interconnected network behind walls of monopoly protection. Every condition that requires an entrant to buy or self-supply bigger pieces of the network or make bigger commitments to the LEC raises the barriers to entry.

C. NEGOTIATE TECHNICAL FEASIBILITY

First, the new entrant would have to prove technical feasibility subject to a host of conditions.

No additional effort: The LECs insist that the entrant's request be under circumstances which require it to make no additional effort for administration, provisioning, maintenance, billing.[25]

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[25]SBC, pp. 27-28; BS, p. 16-17.

"In the longer term, technical feasibility should be determined based upon consideration of, but not limited to the following:

Ability of support systems to administer, provision, maintain, and order without unique or special handling and/or billing;

Ability to provide access with the existing network. ILECs should not be required to alter their networks in order to create feasible unbundling interconnection points or capabilities.

No Change in Network Integrity: The LECs insist that there be no change in the security of the network, whatsoever.[26] This is nothing more than an updated version of the foreign equipment approach which AT&T used to thwart competition for decades. Some of the conditions may be reasonable such as meeting national standards, but others such as requiring predictions about future services are not. Allowing the LECs to claim any change in network integrity as a demonstration of technical infeasibility would result in endless delay of entry. Given that there must now be an external transaction and new physical interaction between

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Ability to deliver network elements which are discrete, stand alone, physical or logical functional components of the existing network, available to meet the required time frames with current or scheduled technology;"

[26]SBC p. 27-28 "Ability to maintain network integrity and security which can be managed without undermining network reliability, increasing the risk of physical damage, service impairment, service degradation, or service outage. or creating a hazard to customers or operating personnel;

Ability to provide and maintain quality of service;

Assuring that physical and/or logical interconnection points are provided so that they meet the service and network security needs of the requesting service provide, the ILEC network, and the public;

Compliance with voluntary national standards;

Ability of a future service/technology to successfully complete ILEC field trial evaluation;

Circumstances in which the point of access can be achieved in a manner that is consistent with applicable industry standards and protocols for equipment intended for the specific environment in which it is located (i.e. central office, outside plant, etc.) consistent with standards the incumbent applies to itself; and

Ability to assign liability resulting from improperly designed plant to the responsible party.

Ability to provide elements to multiple parties."

See also, USTA at p. 12 for a less detailed list.

networks, changes in network security and integrity as well as risk are inevitable. By this definition the LEC has the power to make virtually certain that entry is technically infeasible.

This is a list of requirements for technical feasibility that is so easily manipulated by the incumbent that it would be virtually impossible to refute that claim that a requested unbundling is technically feasible. It allows the incumbent to control the manner of entry of competitors or prevent it altogether.

Preserve Proprietary Protections: While the law expresses a concern for maintaining the integrity of proprietary materials in the process of opening local bottlenecks to interconnection, unbundling and resale, the LEC proposals turn this into a severe barrier to entry.

> "For example, access to elements in a manner that necessarily would reveal a third party's proprietary protocols or to a database that contains the LEC's or any of its customer's (including other carriers) proprietary information should be presumptively not permitted. Any party who seeks access to such elements should carry the heavy burden of demonstrating why another party's proprietary interests should be jeopardized by such access."[27]

By defining proprietary materials as broadly a possible (to include customer information), identifying any use of that information as problematic, and shifting the burden onto entrants, the LECs severely diminish the possibility of entry. Under this model, virtually everything becomes proprietary. For example, after losing competitive bids to supply E-911 equipment, LECs have claimed that their customer databases are proprietary and have refused to allow competing 911 providers to access those databases.

Prove Feasibility on an Office-by-Office, Cabinet-by-Cabinet Basis: The LECs

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[27]BS, p. 35.

propose a very generic minimal form of unbundling, which would force entrants to buy large pieces of the LEC network, and then insist that entrants negotiate any more granular interconnection or unbundling arrangements on an office-by-office, entry-point-by-entry point basis.[28] The result is to recreate the fundamental barrier to entry, forcing entrants to self-supply larger segments of the network, or compete against much smaller segments of the network.

Overcome Partial Access to Rights of Way: The LECs invoke third party obligations (i.e. whether contracts with the owner of the right of way allow incumbent to permit anyone on the property at issue) as a barrier to entry into the network. Entrants would be forced to negotiate anew with third parties and prove the feasibility of access to the vast majority of LEC structures.[29]

D. NEGOTIATE ECONOMIC CONDITIONS

Even if the element were found to be technically feasible by this incredibly subjective, incumbent controlled standard, the new entrant would have to prove that the conditions of the law are met.[30] Although these conditions are part of the law, the assumption on the part of the LECs that the entrant bears the burden of proving them in detail in each and every case is not. Moreover, the LECs put a spin on the conditions in the law that is anti-competitive and add other conditions designed to make entry even more difficult. Indeed, if the goal is as swift a

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[28]USTA, p. 19; BS, pp. 16-17; SBC, pp. 38-42

[29]Ameritech, p. 23.

[30]SBC, p. 36

transition to competition as possible, the Commission's guidelines should place the burden on the incumbent to show that they are not met.

Forced Bundling of Elements: At least one LEC has suggested an interpretation of the relationship between resale and wholesale that would render unbundling virtually useless to entrants. It argues that as long as a wholesale tariff is available for the service for which the unbundled element is declared to be necessary, that the entrant could be forced to buy out of the wholesale tariff, rather than the unbundled, resale tariff.

> By definition, the availability of a service at wholesale rates indicates that a requesting carrier does not need access to the unbundled network elements comprising that service in order to be able to offer the service. The requesting carrier's ability to offer the service at retail is not impaired, and LECs should not be required to unbundle elements merely for the purpose of permitting replication of services available at wholesale rates [31]

This forces the entrant to pay for more elements than are desired and renders unbundling virtually useless to entrants as means to facilitate entry. It also runs counter to the plain language of the Act which requires the incumbent LEC to provide unbundled elements to new entrants regardless of how the new entrant plans to combine them.[32] This statutory requirement exists independent of the wholesale resale tariff requirements.

Demonstration of Demand: SBC would impose an additional hurdle, requiring the entrant to project the level of demand for its service in advance of its entry into the market. This is a virtual impossibility.

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[31]BS, p. 33.

[32]§251(c)(3) "...An incumbent local exchange carrier shall provide such unbundled network elements in a manner that allows requesting carriers to combine such elements in order to provide such telecommunications service.

> One additional factor that clearly should be taken into account in all such analysis is the demonstrable market demand present for the requested unbundled network element.
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> The ILECs will usually be able to determine the approximate costs of any specific unbundling request, but the other necessary side of the equation -- demand -- must be provided by the party requesting the unbundled network elements(s). Unless the Commission can develop an accurate sense of costs versus the projected market demand, it will be unable to determine whether granting a given request for unbundling will result in a useful, efficient expenditure of industry resources, and thus will be unable to make the required public interest determination.[33]

Assumption of Financial Risk: BS also considers the assumption of all financial risk by the entrant to be an economic prerequisite for unbundling. This too is an inappropriate and anti-competitive precondition to entry.

> In addition to these factors specifically delineated by Congress as a minimum, the Commission should also consider the economic reasonableness of the request, particularly as it relates to the allocation of financial risk if the requesting carrier fails to follow through with the purchase of the requested unbundled element. For example, incumbent LECs should be permitted to require requesting carriers to post bond or pay liquidated damages in the event of their nonperformance following an unbundling request. The Commission should consider a requesting carrier's refusal to provide such assurances as sufficient grounds not to require the requested element to be unbundled.[34]

Demonstration of Available Capacity: Even if the unbundled element is proven to be technically feasible and economically necessary to the entrant, it would have to be physically available, under a set of conditions which are under the complete control of the incumbent.

> In the vernacular of the statute, there exists no technically feasible point at which to unbundle an element that does not exist.
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> An example would be where a carrier requests an unbundled loop to a specific

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[33]SBC, p. 98.

[34]BS, p.36.

> customer but all loops to that house are already being used either by the ILEC or other carriers that have previously sought and obtained the other existing loop(s) on an unbundled basis. Under that scenario, the ILEC would have to decline the request due to a lack of capacity. the second carrier wanting access to an unbundled loop at that FDI could not be accommodated. There are obviously many other possible examples (e.g. switch capacity, interoffice trunks) where a requesting carrier may ask for what an ILEC doe snot possess.[35]

Even if we give the benefit of the doubt to the LECs and assume that the ILEC would not claim that a customer who requested to change carriers (i.e. to stop using the loop to connect to the ILEC and use it to connect to the competitor) would be not be prevented from switching, this is still a difficult prospect for entrants. SBC would control entry by controlling capacity. Ironically, it has made an extensive argument that it is extremely difficult to measure switch capacity -- "Any measure of capacity would be useless and inapplicable to the local switching network element."[36] Nonetheless, the incumbents want to require the new entrant to make such a showing. ILECs would have remarkable leverage and ability to claim that there is not adequate capacity and thwart attempts at interconnection and purchases of unbundled elements.

E. NEGOTIATE PRICE

The LECs insist that the negotiated price of interconnection and entry be subject to virtually no restraints. The proposals would allow pricing flexibility up to the limits of what the monopolist would do and, in many respects, the proposals simply recreate the monopolist pricing which the incumbents enjoy today.

Movable Price Floors: Prices would have to fall in a range set only by the limit of

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[35]SBC, pp. 84-85.

[36]Id.

monopolist pricing. They would have to be above short run incremental costs (this prevents price predation).

However, even here the companies insist that they be allowed to immediately price below the tariffed rate through "promotional" offerings (BS, p. 66). This means that the imputation standard for unbundling is different than the imputation standard for pricing. A price squeeze is virtually guaranteed.

Vaulted Price Ceilings: Prices would have to be below stand-alone-cost (i.e. the price it would cost the entrant to build the network on its own) (BS, p. 56).

Here, however, the LECs insist that the sum total of the unbundled elements could exceed the total price of the bundled service it offers [37] This means that the incumbent gets to keep any economies of integration and raised the hurdle of economic efficiency that the entry must overcome.

LEC Pricing Advantages: The LECs have asked for a variety of pricing advantages which would undermine the usefulness of resale.

They ask for a "head start" provision in which services that are "market trials" would not be subject to resale provisions, without stating any geographic, product or time limitation on the trials. When they decide that the trial is over and a general tariff is made available, only then would the service be made available for resale. By focussing the "trial" on the attractive market segment, the service could be substantially mature before competitors get a chance to start offering it.

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[37] "Nor is there any a priori reason to believe that unbundled elements should some way add up to a retail rate," BS, p. 68. Ameritech, p. 56

The LECs also seek flexibility to remove services from the being offered to the public and therefore being made available for resale to entrants. They could simply identify those services in which they are losing market share through resale and eliminate the competition by declaring them withdrawn.

The LECs want to be able to offer "customer-specific contract arrangements." They can do so sequentially without limit, without ever making such arrangements publicly available. Therefore, they avoid having to make the rate available for resale.

The LECs also seek the right to offer only averaged rates for resale while they can deaverage their retail rates.[38] This places the entrant at an immediate disadvantage because the new entrant will be forced to buy at average rates while the LEC meets competition with the deaveraged rates.

D. DO NOT PASS GO, DO NOT COLLECT UNBUNDLED ELEMENTS

Go to Arbitration: The LEC's want the ability to claim any and all of the above conditions as reasons to refuse to reach an agreement. They also suggest in a number of cases that the refusal of an entrant to accept their view of the technical or economic conditions constitutes demonstration of bad faith negotiation. In essence, they want a one-sided negotiation where new entrants play by the incumbents rules or they don't play at all. Once they go to

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[38]Ameritech, p. 58.

> The federal regulations ultimately adopted should provide that LECs may offer a single resale rate when more than one retail rate is offered in connection with a single service (e.g. a service with peak and off-peak rates), provided that the single rate represents the weighted average of all the retail rates, less avoided costs, for the service in question.

arbitration, the LECs would have the incumbent get all the benefits with no risk.

Renegotiate or Go to Court: Regardless of how we get to arbitration, as the LECs see it, it counts for little. If the entrant succeeds in convincing the arbitrator that the incumbent is wrong, it wins virtually nothing. Under the SBC approach, LECs would not be bound by any such decision.[39]

> Congress did not intend for parties to "be bound" by arbitration decisions under the Act in the sense that they are legally obligated to enter into an agreement after receipt of the arbitrator's decision . Clearly, if they decide to enter into an agreement, then they must incorporate the arbitrator's decision (unless of course they decide to re-negotiate the entire agreement), but it is equally clear that they are not legally obligated to enter into any agreement at all after an arbitration decision if either party at that point does not wish to do so...
>
> In any event, the law is clear that in the case of compulsory arbitration, as in the Act, unless the parties agree in advance to be legally bound by the result they cannot be bound, and are entitled to a de novo court determination of the issues. The Act does not supplant the law of arbitration in the United States, which is well-developed and widely understood.

If the entrant does not agree to renegotiate after it wins the arbitration decision, the whole process starts over as a court case.

LECs Get Relief Immediately, and Whether or Not Negotiations Succeed: The most ironic twist of fate would come if the USTA proposal to allow LEC entry into long distance when negotiations start and SBC proposals to render negotiations non-binding are combined. Under the SBC proposal entrants are not likely to get relief even if incumbents fail at arbitration. USTA insists that LECs get entry into long distance at the start of negotiations, fearing that protracted negotiations could restrain RBOC entry into long distance. Since SBC endorses the USTA proposal, it is asking relief for itself at the start of negotiations, but reserves the right to

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[39]SBC, pp. 104.

reject the outcome of arbitration should negotiations fail.

Again, this represents a case where the incumbent LEC receives all of the upside opportunity with no downside risk. This is exactly the opposite of what Congress intended -- to eliminate the inherent anti-competitive benefits of the local monopoly and only then confer the benefits of entry in long distance onto the LEC

CONCLUSION

Wherefore, CFA and CU urge the Commission to reject attempts by the incumbent LECs to retain their monopoly advantages and discourage local competition through strained reading of the 1996 Act and instead establish guidelines designed to help states bring competition to all telecommunications market as swiftly as possible through maximum unbundling and TSLRIC pricing of network elements and rules for effective resale of local services.

Respectfully submitted,

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May 30, 1996